In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 914

GEORGE R. TOLLEFSEN and MARGARET A. TOLLEFSEN,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Pet. App. 9a-26a; R. 134-145)[1] are reported at 52 T.C. 671. The opinion of the court of appeals (Pet. App. 1a-8a) is not yet reported.

[1] "R." references are to the record appendix filed in the court of appeals.

JURISDICTION

The judgment of the court of appeals was entered on June 19, 1970. By order dated September 16, 1970, Mr. Justice Harlan extended the time for filing a petition for a writ of certiorari to and including October 31, 1970. The petition was filed on October 29, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the court of appeals correctly sustained the Tax Court's determination that cash withdrawals by petitioner[2] from an inactive, wholly owned subsidiary corporation, whose parent corporation was, in turn, wholly owned by petitioner and his wife, were taxable dividends and not loans.

STATUTES INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954 are set forth in the Appendix to the petition (Pet. App. 27a-29a).

STATEMENT

Petitioner and his wife owned all of the stock of Tollefsen Brothers, Inc. ("Brothers"), which in turn owned all of the stock of Tollefsen Manufacturing Corp. ("Manufacturing"), an inactive corporation.

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[2] References to "petitioner" are to George R. Tollefsen. Margaret A. Tollefsen is a party hereto only because she filed a joint income tax return with her husband for the year in issue.

In 1960 and 1961, petitioner withdrew cash from Manufacturing in the net amounts of $27,810.97 and $24,665.40, respectively. The withdrawals were reflected as loans on Manufacturing's books and were evidenced by petitioner's non-interest bearing demand notes. At no time did petitioner pay interest on the funds withdrawn. Although he claimed that he withdrew the funds to carry on Manufacturing's business, he did not use the funds for this purpose, but rather to advance his own business interests. (Pet. App. 2a-3a, 22a-23a; R. 135-137.)

In June 1964, the Internal Revenue Service began the audit which ultimately led to the deficiency determination here in issue. Until that time, petitioner made no repayments of any of the funds withdrawn from Manufacturing in 1960 and 1961. Only thereafter did he make advances on behalf of Manufacturing for which he received credits totalling $11,916.80. The credits, although not formal repayments, were sufficient to offset in full the amounts of the first two notes which petitioner gave to Manufacturing in 1960, and they were marked to indicate repayment. As of the time of the Tax Court hearing, no repayments had been made on account of any of the 1961 withdrawals. (Pet. App. 3a-4a; R. 139-140.)

The Tax Court found on these facts and on the basis of petitioner's demeanor at trial that he had not intended, at the time of the withdrawals, to make repayment to Manufacturing. The Tax Court also found that the withdrawals were, in substance, distributions from Manufacturing to its parent, Brothers, which in turn distributed the funds to its sole

shareholders, petitioner and his wife. It held, in accordance with these findings, that petitioner's net withdrawals in 1961, the only year in issue, constituted taxable dividends from Brothers pursuant to Sections 301 and 316 of the Internal Revenue Code. (Pet. App. 21a-26a.) On appeal, the Second Circuit affirmed (Pet. App. 1a-8a).

ARGUMENT

The decision below is correct. There is no conflict or any other reason for further review.

1. The Tax Court correctly found that at the time of the withdrawals, petitioner did not intend to repay Manufacturing. This finding is supported by substantial evidence, as the court of appeals held (Pet. App. 5a), and there is, therefore, no occasion for review of the finding by this Court. *Comstock* v. *Group of Investors*, 335 U.S. 211, 214.

Likewise correct is the conclusion of the courts below (Pet. App. 7a, 25a-26a) that the transaction in question is to be characterized for tax purposes as consisting of two steps: first, a transfer of funds from Manufacturing to Brothers, and second, a constructive dividend distribution from Brothers to petitioner and his wife. This conclusion fully comports with the uncontroverted facts of this case; for it was petitioner's unfettered control over Brothers, which in turn controlled Manufacturing, that permitted him to compress what was essentially two steps into one, and thereby to withdraw funds from Manufacturing directly. See *Young* v. *Commissioner*, 5 T.C. 1251 (1945).

2. Petitioner's assertion of conflict (Pet. 14-16) with decisions of this Court holding that, in certain circumstances, a separate corporate entity is not to be disregarded rests on a misconception of the holdings below. Neither the Tax Court nor the court of appeals disregarded the separate existence of Brothers and Manufacturing. On the contrary, both recognized that Brothers and Manufacturing were separate entities by treating the transaction as a distribution of funds from Manufacturing to Brothers and a redistribution from Brothers to petitioner and his wife. The holdings below thus rest on the settled principle that the substance of a transaction, not its form, is determinative of the tax consequences. See, *e.g.*, *Knetsch* v. *United States*, 364 U.S. 361.

3. There is no merit to petitioner's claim (Pet. 20-22), advanced for the first time in this Court, that the Tax Court was without jurisdiction to determine that petitioner received a dividend from Brothers. This argument is based on the mistaken premise (Pet. 20) that "[t]he statutory notice of deficiency, the pleadings and the evidence heard by the Tax Court were confined to the issue whether subsidiary [Manufacturing] paid a taxable dividend in amount of $24,665.40 to petitioner." In fact, the Commissioner's contention was not so restricted either in the deficiency notice or in the Tax Court. The notice (see Pet. App. 21a) does not state from whom the dividend was claimed to have been received, but only that a dividend was received; the issue framed by the pleadings (R. 4-5, 134-135) is whether the Commissioner's determination is correct; and the Commis-

sioner argued in the alternative in the Tax Court (Reply Brief, p. 10) that the distribution should be treated as a dividend from Brothers. If petitioner had additional evidence on this aspect of the case, he should have sought to reopen the Tax Court proceedings.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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